

CERTIFICATE LEVEL

ACCOUNTING

CHAPTER 1

INTRODUCTION TO ACCOUNTING

Topics covered

- ❑ Definition of Accounting
- ❑ Financial statements of an entity
- ❑ The objectives of financial statements
- ❑ Users of financial information
- ❑ Regulation of accounting & ethical consideration
- ❑ Conceptual framework-qualitative characteristics
- ❑ Accounting concepts and conventions
- ❑ Question Analysis-past questions and self- test

Definition of Accounting

Accounting is a way of recording, analysing and summarising the transactions of an entity.

Financial statements of an entity

Components:

1. Statement of financial position as at the end of the reporting period
2. Statement of profit or loss and other comprehensive income for the period
3. Statements of changes in equity for the reporting period
4. Statement of cash flows for the reporting period

Financial statements (FS) of an entity

5. Notes comprising a summary of significant accounting policies and other explanatory information

6. A statement of financial position as at the beginning of earliest comparative period when an entity applies an accounting policy retrospectively, makes restatements of items in the FS or reclassifies items

Objectives of financial statements (FSs)

As per framework for preparation and presentation of FSs:

To provide information about financial position, financial performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions and assess followings-

- Ability of the entity to generate cash, and
- The timing and certainty of cash flows.

Objectives of financial statements

As per IAS 1:

- To show the results of management's stewardship of the resources entrusted to it, and
- To help users of FSs in predicting the entity's future cash flows and its timing and certainty.

Users of financial information

- ❑ **Owners-** to assess management performance & profitability and make decision about dividend & new investment,
- ❑ **Investors-** to assess risk and return from investment, to decide whether to buy, hold or sell shares,
- ❑ **Suppliers and finance provider-** to assess ability to pay debt,
- ❑ **Customers-** to assess ability to supply secured products,

Users of financial information

- ❑ **Employees-** to assess career development opportunities,
- ❑ **Income tax authorities-** to assess entity's tax liability,
- ❑ **Government and other agencies-** to regulate activities of the entity and determine tax policies,
- ❑ **The public-** to assess effect of the entity on the economy.

Note: *framework does not identify managers primarily as user of financial statements but instead as being primarily responsible for their preparation & presentation.*

Regulation of accounting & ethical consideration

Regulation:

1. Legislation
2. Accounting concepts and individual judgements
3. Accounting standards (IFRSs/ IASs)
4. GAAP

Ethical consideration-

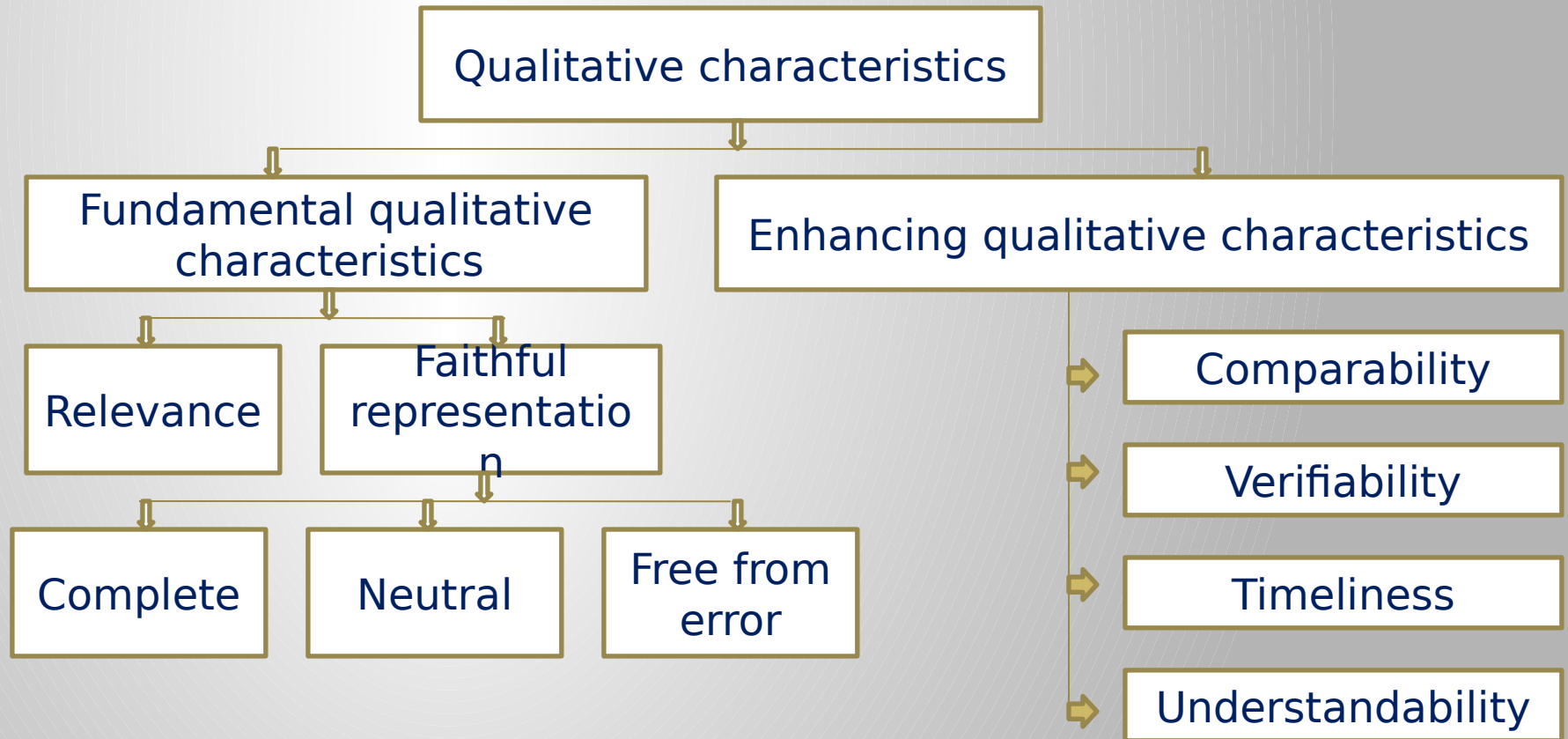
IFAC code of ethics

ICAB code of ethics

Conceptual framework

It sets out the concepts that underlie the preparation and presentation of FS for a wide range of users.

Qualitative characteristics



Fundamental qualitative characteristics

1. Relevance- influence decision of users (material).

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2. Faithful representation:

Characteristics: complete, neutral and free from error

Enhancing qualitative characteristics

- 1. Comparability :** with other entity and over the years
- 2. Verifiability:** supported by evidence
- 3. Timeliness:** before making decision
- 4. Understandability:** to users having reasonable knowledge of business and economic activities.

Accounting concepts and conventions

- ❖ Fair presentation, true and fair view, faithful representation
- ❖ Departure from IASs
- ❖ Going concern
- ❖ Accrual basis of accounting
- ❖ Consistency of presentation
- ❖ Materiality and aggregation
- ❖ Offsetting
- ❖ Business entity concept
- ❖ Historical cost conventions
- ❖ Capital and revenue expenditure

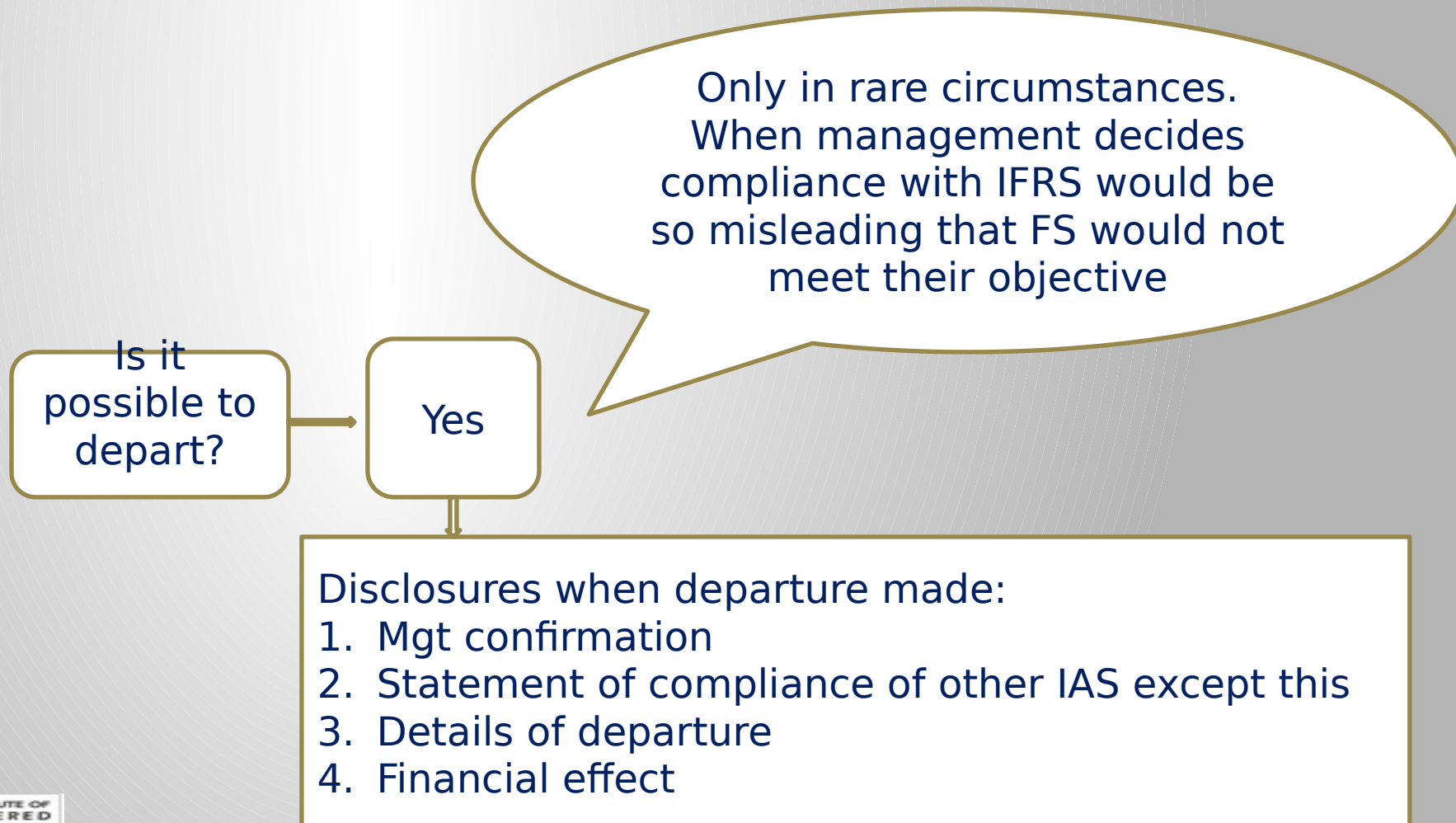
Fair presentation, true and fair view, faithful representation

Conceptual Framework: Financial information must be relevant and faithfully represent what it purports to represent.

Companies Act: FSs should give a true and fair view of the financial position of the entity at a particular point in time.

IAS 1: FSs present fairly the financial position and performance and cash flows of the entity. It requires faithful representation of the effects of transactions, other events and conditions.

Departure from IFRSs/IASs



Going concern

- ❑ The entity is viewed as continuing in operation for the foreseeable future. It is assumed, the entity neither has the intention nor the necessity of liquidation.

Consistency of presentation

- ❑ Presentation and classification of items in the FSs should stay same from one period to the next.
- ❑ Exceptions: change in operation, change is more appropriate or required by IFRS.

Materiality and aggregation

- ❑ Omissions and misstatements of items are material if they could, individually or collectively, influence the economic decision of users taken on the basis of the FSs. It depends on size and nature of omission or misstatements. Items of dissimilar nature and function shall be presented separately unless they are immaterial

Business entity concept

- ❑ Business is regarded as separate entity, distinct from its owners and managers.

Offsetting

- ❑ Assets and liabilities and income and expenditures must be presented separately. IAS 1 does not allow offsetting unless-
 - ✓ A IFRS requires or permits,
 - ✓ Gains/losses and expenses arising from same transaction are not material in aggregate.

Accounting concepts and conventions

- ❑ Capital expenditure: Expenditure which results in the acquisition of long-term assets or an improvement or enhancement of their earning capacity. Long term assets are kept in the entity for more than one year.
- ❑ Revenue expenditure: expenditure incurred for trade purpose or for maintaining the existing earning capacity of long-term assets.



Thank You!

